2013 RATE APPLICATION
NARRATIVE SUMMARY

March 14, 2013

Recology Sunset Scavenger
Recology Golden Gate
Recology San Francisco

I. OVERVIEW

A. MANAGEMENT OF RESOURCES IN SAN FRANCISCO

The City of San Francisco is recognized as a world leader in environmental stewardship. In 2011, San Francisco was named the Greenest City in North America, in large part due to its number one ranking in waste management. In 2012, San Francisco announced that it had achieved 80 percent landfill diversion, again demonstrating international leadership for a major urban city. The San Francisco collection and processing companies – Recology Sunset Scavenger, Recology Golden Gate, and Recology San Francisco (the "San Francisco Companies" or "Companies") – work in concert with the City to achieve these important goals. The combined efforts of the City and the Companies have been the focus of local, national, and international media coverage as one innovative achievement after another has been recognized.

The City is not resting on its past accomplishments. San Francisco's Board of Supervisors has passed two major policy initiatives that steer the City forward to even greater environmental stewardship: (1) the Mandatory Recycling and Composting Ordinance (the Mandatory Ordinance) and (2) Zero Waste by 2020.

1. Mandatory Recycling and Composting Ordinance

The Mandatory Recycling and Composting Ordinance took effect in October 2009. It requires all residents and businesses to separate discarded materials into three streams – recyclables, compostables, and trash. While the City's residential and commercial customers have been served by this three-stream system for about ten years, until passage of the Mandatory Ordinance, participation had been voluntary. The Mandatory Recycling and Composting Ordinance not only mandated full compliance with the separation system, it also included enforcement provisions.

The Ordinance has resulted in substantial impacts to both service and customer billings. As a result of the Ordinance, participation increased and diversion rates picked up significantly, particularly as previously non-participating or poorly-participating multi-family and commercial customers moved to greater recycling and composting service. Presently, residential/apartment customers are billed solely on the basis of trash bin volume and commercial customers receive steep discounts on recycling and composting services. As a consequence of the current rate structure, billings to customers decreased as trash service (black landfilled stream) decreased and recycling service (blue stream) and composting service (green stream) increased.

The current rate structures for both residential/apartment rates and commercial rates were designed to promote diversion, and both provide strong financial incentives for customers to orient their service to diversion (recycling and composting services). Under these structures, however, as the diversion programs became more successful and the service configuration shifted, the Companies' revenues have decreased. At the same time, costs have increased related to the additional recycling and composting services provided. Any cost reductions in

providing reduced trash services have been far outweighed by additional cost of expanded recycling and composting services.

2. Zero Waste By 2020

Zero Waste by 2020 is a policy goal adopted by the City in 2003. Zero waste includes eliminating tonnage from going directly to landfill and finding the highest and best use for all discarded materials. Achieving zero waste is a very challenging goal that will require significant planning, infrastructure investment, and changes to collection and processing operations. The Companies have been working with the City to identify the necessary system improvements, including the incorporation of new waste processing technologies and changes to collection practices. These planning activities will continue during the near-term horizon covered by this rate application. In addition, the Companies will begin the challenging task of processing the trash stream (i.e., black bins) to further reduce the quantity of materials being landfilled.

B. RATE APPLICATION GOALS AND OBJECTIVES

The fundamental goal of the Companies in submitting this rate application is to obtain approval for fair and reasonable rates that will generate sustainable revenues to allow the Companies both to maintain quality service and to continue developing and operating innovative programs to help the City attain its ambitious diversion goals. The Companies' application is driven by two main objectives:

- Begin implementation of sustainable zero-waste residential and apartment rate structures.

- Advance the effort to achieve zero waste by 2020

The rate application includes a request for revenue adjustments equal to 21.51% from each customer segment (residential, apartment, and commercial). Individual customer rate increase percentages will vary depending on their respective volume and composition of service. Customers who in the past have received recycling and composting services without a specific charge related to those services may see rate increases greater than the average increase.

C. RATE APPLICATION PROCESS

The rate application process follows the Rules of Procedure set forth in Department of Public Works (DPW) Order No. 180,851. The Companies are proposing a one-year rate period beginning on July 1, 2013 and ending on June 30, 2014. Cost of Living Adjustments (COLA) would be applied in subsequent rate years until new rates are established as a result of a new application process.

D. WEBSITE: www.SFZeroWasteRates.com

To promote transparency in the rate application review process, the Companies have established a website to make facts and information about the rate application easily available

to San Francisco residents. Customers can find information about the rate process at www.SFZeroWasteRates.com.

II. PROGRAMS INCLUDED IN THE RATE APPLICATION

A. CURRENT PROGRAMS

The rate application assumes that programs currently provided to San Francisco's residential and commercial customers will continue in the new rate period. These programs play an integral role in achieving the City's diversion goals. The core of the system is the three-stream collection of recyclables, compostables, and trash from residential, apartment, and commercial customers. In addition, the three-stream program is augmented by a variety of specialized collection and processing operations.

Current programs and operations to be continued include:

1. COMINGLED RECYCLABLES COLLECTION (Blue Stream): Residential and commercial collection of comingled recyclable, including paper, glass, aluminum, tin cans, and hard plastics (cups, tubs, lids, buckets, and toys without wires or metal parts).

2. COMPOSTABLES COLLECTION (Green Stream): Residential and commercial collection of food scraps, plant materials (yard waste), and soiled paper.

3. TRASH COLLECTION (Black Stream): Residential and commercial collection of non-recyclable and non-compostable materials.

4. BULKY ITEM RECYCLING (RecycleMyJunk.com): Special collection and recovery of bulky items, such as appliances, electronics, furniture, scrap metal, and wood through scheduled pick ups to facilitate customer participation and maximize recycling.

5. CURBSIDE BATTERY RECYCLING: Customers place batteries in zip-lock bags and place them on top of their black bins. Trash collectors place them in a special bucket in the collection truck. Workers at the transfer station then sort the batteries according to DOT rules and ship them to battery recycling facilities.

6. COMMERCIAL WOOD, SCRAP METAL AND LARGE PLASTIC RECYCLING: Special routes collect broken pallets from warehouses, wood scraps from cabinetmakers, and car doors and bumpers from auto shops, which are then sorted and recycled.

7. WINDOW GLASS RECYCLING: Glass from window shops and commercial customers is collected.

8. CHRISTMAS TREE RECYCLING: Christmas trees are collected at the curb during the first two weeks of January, chipped, and used at biomass facilities.

9. CONSTRUCTION-AND-DEMOLITION WASTE RECYCLING: As buildings are constructed, remodeled or demolished, metal, wood, sheetrock, rigid plastic, and other construction materials are captured in debris boxes, then taken to Recology's

construction-and-demolition recycling facility (iMRF) for sorting.

10. HOUSEHOLD HAZARDOUS WASTE DROP OFF: Recology operates the San Francisco Household Hazardous Waste Collection Facility (HHWCF), where residential customers can drop off household hazardous wastes (e.g., paint, oil, pesticides, and household chemicals) three days per week for safe recycling and disposal. This facility has been open since 1987 and was the first permanent HHWCF in the nation.

11. DOOR-TO-DOOR HOUSEHOLD HAZARDOUS WASTE COLLECTION: Recology also collects household hazardous wastes directly from homes using specialized trucks for handling and transporting these materials.

12. VERY SMALL QUANTITY GENERATOR PROGRAM: Qualifying small business generators of hazardous waste in San Francisco may use the HHWCF by appointment for a fee on designated days each month.

13. E-WASTE RECYCLING: Most electronic waste is banned from landfill in California. Fluorescent tubes, monitors, televisions, computers, and other electronics are collected from drop-off locations, curbside collection appointments, and the transfer station then shipped to facilities specializing in recycling specific types of e-waste.

14. SAFE NEEDLE PROGRAM: The San Francisco Safe Needle Disposal Program (SFSNDP) provides San Francisco residents with safe, convenient disposal of home-generated sharps at more than 70 pharmacies throughout the City. Residents can pick up empty sharps containers at participating pharmacies, fill them, and then return them for disposal as medical waste.

15. SELF-HAUL RECYCLING: Recology operates a special sorting line to recycle wood, metal, rigid plastic and other materials self-hauled by individuals and small contractors to the Public Reuse and Recycling Area (PRRA) at the Tunnel and Beatty facility.

16. PERFECTLY-GOOD REUSE PROGRAM: Recology pulls items that are in good condition for reuse (e.g., bicycles, furniture, clothing) from loads brought to the PRRA by individuals and small contractors. The re-useable items are either donated directly or given to organizations (e.g., St. Vincent DePaul) that process them for distribution in thrift stores.

17. MATTRESS RECYCLING: Mattresses from residents, hotels, and designated collection trucks are loaded into trailers at Tunnel and Beatty and transported to a local company specializing in mattress recycling.

18. TEXTILE DROP-OFF AND COLLECTION: Residents and businesses can drop off textiles at the PRRA. In addition to the drop-off, Recology collects source separated textiles from businesses that manufacture clothing and cut garment patterns. Residents can also have textiles collected through Bulky Item Recycling. The textiles

are sent to reuse and recycling markets.

19. TOILET RECYCLING: Old toilets are segregated from the waste stream and transferred to a company that specializes in porcelain recycling. Prior to shipment, toilet seats and lids are removed and baled with other rigid plastics for recycling.

20. TIRE RECYCLING: Used tires are handled separately at Tunnel and Beatty and then taken to a company that shreds and recycles the rubber.

21. STYROFOAM DROP-OFF: Residents and businesses can drop off clean styrofoam blocks at the PRRA for recycling. Recology San Francisco operates a special densifier that condenses loose pieces of styrofoam into ingots, which are recycled into such products as base boards and moldings.

22. FILM PLASTIC DROP OFF: Residents and businesses drop off clean polyethylene film plastic (e.g., plastic bags) at Recycle Central at Pier 96 and the PRRA for recycling. The film plastic is baled and shipped to plastic recycling markets.

23. PUBLIC LITTER CAN COLLECTION: Recology collects from over three-thousand public litter cans distributed around the City. Each can is emptied at least once per day, and some cans are emptied regularly as many as three times per day. Cans emptied more than once are emptied outside of the regular route service and on demand within 2 hours of notification of service necessity by the City.

24. DISTRICT CLEAN-UP EVENTS: Special clean-up events are held at least annually in each of the City's eleven Supervisorial Districts to allow residents to drop off items too big to fit in the regular collection bins, including all three refuse streams. Motor oil, batteries, and fluorescent lamps are also accepted.

25. EVENT RECYCLING: Recology provides recycling and composting collection services to neighborhood festivals and major functions such as the Chinese New Year Parade and the Pride Parade.

26. CONCRETE AND ASPHALT RECYCLING: Recology's Sustainable Crushing operation crushes and recycles concrete, asphalt, bricks, and porcelain into recycled construction products. Our aggregate and engineered-fill products not only displace virgin materials, but they play an integral role in a closed-loop recycling system, whereby old City streets and structures are recycled back into similar construction uses within the City by local companies.

27. CONCRETE REUSE: Recology also utilizes excess wet concrete from cement companies for creating building-block products as well as on-site construction applications.

28. BUY-BACK CENTERS: Recology operates buy-back centers for customers who want to bring in bottles and cans for deposit redemption.

29. ARTISTS IN RESIDENCE: Recology sponsors an artist in residence program to

demonstrate the possibilities of creative reuse of materials and to promote recycling. The Company sponsors about 8 residencies per year through this award-winning program, providing work space, access to materials, administrative support, and exhibition opportunities.

30. EDUCATIONAL TOUR PROGRAM: Recology provides educational tours to thousands of children and adults annually. The focus of the tour is on recycling, composting, reuse, and resource conservation. The tour includes visits to Recycle Central and Tunnel and Beatty.

31. COMPOST GIVEAWAY: Periodically, Recology provides free compost to San Francisco residents at various locations in the City. In addition, free compost is provided at District Clean Up events. The compost is derived from food and garden wastes generated in San Francisco, collected by Recology, and composted at one of Recology's composting facilities.

The Companies and the City have worked together for many years to provide the public education and outreach needed to support these programs, and the continued success of the programs requires on-going public education and outreach efforts. General outreach and specialized, targeted outreach programs will continue through the rate period and beyond.

B. NEW PROGRAMS

The Companies are proposing new programs, detailed below, to help move the City towards zero waste. The Companies endeavor to hire qualified San Francisco residents whenever possible to staff these new initiatives.

1. Trash Processing

In 2013, Recology San Francisco plans to begin processing a portion of the trash (black bin) stream. The processing operation will be conducted on the west side of the transfer station. The processing equipment consists of a bag breaker, a mechanical screen, a sorting platform and conveyor, a Bio Separator, and associated transfer conveyors. Black stream loads will be unloaded onto the transfer station floor and inspected for prohibited wastes. The waste will then be loaded into the bag breaker and fed through to the screen. Large materials that do not pass through the screen will be sorted for recovery (e.g., metals, glass, paper, plastic containers). Small materials that pass through the screen (unders) will be loaded into the Bio Separator, which separates the waste into two streams: an organic-rich material suitable for anaerobic digestion and/or composting and a separate stream consisting mostly of plastic and other non-organic materials. The objectives of this project are to achieve increased diversion of materials from landfilling and to gain experience with trash processing, thereby providing insight and experience in advance of the zero waste facilities design.

2. Abandoned Materials Collection

At the request of the City, the Companies have proposed the assumption of a part of the abandoned materials collection program currently operated by the DPW compactor trucks.

This proposed program includes the collection of items identified through the City's 311 reporting system, along with abandoned materials identified by Company personnel. The Companies propose to operate the program similar to Bulky Item Recycling, with utilization of five rear-loading packer trucks, five box trucks (for mattresses, electronics, appliances, etc.) and one pickup truck. Each crew would consist of two drivers, one in a rear loader and one in a box truck. Drivers would be assigned to a specific service area, and would be routed to collect abandoned materials reported through the 311 system. The company's goal is to respond to abandoned waste requests within a four-hour window on weekdays and an eight-hour window on weekends and holidays. Drivers would also be expected to collect any abandoned materials present on their routes where practical, even if it is not part of the 311 calls. All stops and collections will be documented. This program structure will increase collection and diversion of abandoned materials.

In addition to collection of materials related to 311 calls, the abandoned materials program will provide support for events identified by the City, including selected parades, festivals and holidays. The proposed plan includes all program costs, including 10 drivers each weekday, 8 drivers on Saturday, 6 drivers on Sunday, supervision, administrative support, vehicle costs, and disposal costs corresponding to expected tonnage.

3. Public Litter Can Maintenance

During the last year the Companies have expanded their collection of public litter cans at the direction of DPW to address an increased level of activity in the City and to assist DPW with litter control. The Companies currently operate 10.5 dedicated public litter can collection routes seven days per week, and a small part time sweep truck during the work week on Market St. Mission St. and the Financial District transit corridors. In addition to servicing the cans with regular route and sweep trucks we also employ a rover position that walks the shopping districts in Union square seven days per week during the Holiday shopping season from mid-November through mid-January and also during the summer from June through September. The combination of the dedicated route trucks, sweep trucks and rover helps to ensure that all of the public litter will receive adequate service throughout the day. The Companies are working with the City's 311 Customer Service and Dispatch System to better deploy resources and have agreed to respond to service issues within two hours of receiving a request from the 311 system. The Companies are also proposing to procure and implement a route tracking system to manage the additional public litter can routes.

In addition to the services described above, the Companies are proposing to assume responsibility for replacement of liners and doors for all public litter cans. This additional service will be performed by existing Company personnel and will be added to their current responsibilities without an increase in headcount. DPW will supply the Companies with liners and doors as necessary to maintain the public litter cans. The City, through DPW, will retain responsibility for major can repairs, installation and removal, graffiti abatement, and steam cleaning.

The Companies are proposing to fund the replacement of up to five hundred (500) newly designed public litter receptacles to support DPW Street Environmental Services. The funds

will be collected and transferred to the Impound Account and new receptacles will be purchased and installed by DPW Street Environmental Services. The current estimated procurement cost for a public litter receptacle is $1,680.00, not including any installation charge.

C. CONTINGENT SCHEDULES

The Companies are proposing two contingent schedules that would be triggered upon future actions by the Companies and corresponding future approvals by the City. These costs are not included in the base rate application.

1. Contingent Schedule 1 – Zero Waste Facility Expansion

Providing the infrastructure necessary for meeting the City of San Francisco's zero waste goals requires the expansion of Recology's Tunnel and Beatty facilities. Achieving zero waste will involve processing all materials, including the trash (black bin) stream. In addition, more advanced processing of the recycling (blue bin) and composting (green bin) streams is envisioned for the future in order to divert more materials from landfill and to ensure sustainable markets for recovered materials. The additional processing operations would take place in new facilities that cannot be accommodated on the existing site. Contingent Schedule 1 addresses the costs associated with the acquisition of additional land necessary for the zero waste infrastructure. The Companies are requesting that reasonable carrying costs for the land investment be included in the rates. The request for reimbursement follows a utility regulatory framework covering land acquired for future use. The proposed contingent rate would become effective once Recology takes possession of the land. The proposed increase related to the land purchase would be adjusted to reflect the actual cost of the acquired land but would not exceed 0.67 percent, or $0.19 on the 32 gallon black bin rate.

2. Contingent Schedule 2 – West Wing Project

Infrastructure at Recology's Tunnel and Beatty site is space-constrained (as noted above). The Companies have identified one near-term facility-expansion opportunity to provide building space for testing and developing the processing technologies needed to achieve zero waste. This project would involve constructing a west wing next to the existing transfer station. The West Wing Project would provide approximately 13,500 square feet of additional building area. It is envisioned that following construction of the zero waste facilities, the west wing building would be used for either specialized recycling operations or maintenance of mobile equipment used in the transfer station and in the construction-and-demolition recycling facility located on the east side of the transfer station. The Companies are requesting that building costs be added to the rate base following submittal of proof of first payment to the building contractor. The proposed contingent increase would be adjusted to reflect the actual cost of construction but would not exceed 0.16 percent or $0.04 on the 32-gallon bin rate.

III. CHANGES TO RATE-SETTING METHODOLOGIES

1. Residential Rate Structure

The current residential rate structure was designed to incentivize residents to participate in diversion programs by billing residential customers solely on the basis of trash service volume. During the last rate process, the black bin rate was set to cover all of the estimated costs of the residential collection program at that time, including fixed costs and costs associated with the recycling (blue) and composting (green) streams. As the City moves toward zero waste, it is widely recognized that the refuse rate structure needs to be reconfigured, as higher levels of diversion are accompanied by a shrinking volume of trash. Since the current residential rate structure applies total system costs to that shrinking volume, residential revenues are not sustainable based on the current rate configuration. In addition, since a growing portion of the overall system costs (both collection and processing) are related to the costs of the recycling and composting streams, it is a natural evolution of the rate structure to include charges for those streams now and into the future. The proposed rate structure for residential rate customers includes a nominal charge of $2.00 per 32 gallons of capacity for the recycling and composting streams. This charge is not expected to impact the amount of recycling and composting service provided. Customers are still incentivized to move towards recycling and composting service as the proposed volumetric charge for these diversion services is substantially less than the proposed volumetric charge for trash service.

In addition to the variable cost changes described above, the Companies are proposing a fixed charge of $5.00 for each residential dwelling unit to be included in the new residential rates. The fixed charge is intended to cover some of the fixed system costs, including capital costs, administrative costs, and regulatory costs.

Individual residential customer rate increase percentages will vary depending on their respective volume and composition of service. Customers who in the past have received additional diversion services without a specific charge related to that service may see rate increases greater than the base increase. A typical residential customer with three 32-gallon bins will see an increase from $27.91 to $34.51 per month.

2. 20-Gallon Rate

The Companies are proposing to charge 20-gallon trash customers at 20/32 (62.5 percent) of the 32-gallon rate, rather than the previously established 77 percent. Consequently, all volumetric charges for residential customers are now proportional. 20-gallon customers will also be subject to the charges for recycling and composting services discussed above. Recycling and composting services are provided to all residential customers, including 20-gallon trash customers, in 32-gallon increments only. In addition, 20-gallon customers will also be subject to the fixed charge for single-family dwellings described above.

The change in the volumetric charge for the black bin described above reduced the overall increase for the 20-gallon customers. A typical residential customer with a 20-gallon black bin will see an increase from $21.49 to $24.94. This is intended to partially mitigate the total magnitude of the increase for these customers.

3. Apartment Rate Structure

During the last rate process, apartment customers and apartment rates were conformed to the residential rate structure. At that time, the uniform structure was effective in providing incentives for apartment customers to move toward recycling and composting service. This was important to support the diversion programs during their development stage. Since that time, there has been a substantial increase in recycling for apartment customers. With the maturity of these programs, institutionalization of recycling and composting as accepted practices, and the adoption of the Mandatory Ordinance discussed above, the apartment rate structure needs to evolve in order to continue providing incentives to apartment customers to increase their diversion services while stabilizing the revenue stream and addressing the overall cost of providing the service.

The Companies are proposing to implement a discounted volumetric apartment rate structure patterned after the commercial rate structure adopted in 2006. The new structure includes a fixed charge and equal volumetric charges for all service volume, irrespective of the type of service. These volumetric charges are partially offset by discounts for the proportional amount of recycling and composting service. The details of the proposed apartment rate structure are summarized below.

The proposed structure includes a $5.00 per dwelling unit fixed charge. This charge is the same as the per unit fixed charge proposed for residential customers. The fixed charge is intended to cover some of the fixed system costs, including capital costs, administrative costs, and regulatory costs.

In addition, the proposed structure includes volumetric charges equal to $25.51 per 32 gallons of weekday service, irrespective of type of service. This change applies the proposed residential black bin charge to all service volumes. The calculated gross revenue is largely offset by the discounts available for recycling and composting services, as described below.

Discounts of up to 75% of the volumetric charges are calculated from each customer's diversion percentage as a percentage of total volume, less 10%. The first 10 percent of diversion is not eligible for a discount due to the fact that there is a minimum level of diversion service required by the Mandatory Ordinance. This discount structure rewards customers that have more diversion services and encourages others to migrate towards more diversion service. As customers increase their recycling and composting services and their discount percentage, they will be able to partially mitigate the rate increase. As an example, if a customer has 3 equal size bins (one for each of the black, blue and green streams) they have a 67 percent gross volumetric discount rate. The discount they would receive on their volumetric charges is 57 percent (67% – 10%). If the customer added another recycling bin, the discount would become 65 percent (75% – 10%).

To partially mitigate the impact of implementing this structural change, the Companies are proposing to include a two-year cap for all apartment customers. The first year cap would limit the increase under the new structure to 25 percent of current charges, moving to 50 percent in the second year, and finally 100 percent, or the full effect of the structure, in the third year. The caps will allow ample time for customers to embrace the new structure and

adjust service levels to mitigate further rate increases. It is anticipated that changes to service levels and configuration will offset any additional revenue generated by the removal of the caps.

4. Commercial Rate Structure

Commercial rates were reconfigured in 2006 to recognize the desire to move towards zero waste, and encourage commercial customers to help the City reach higher diversion goals through economic incentives. The commercial rates currently include a base component and a variable service component, with a discount available on the variable service component based on the proportion of recycling and composting services to the total service volume. The variable service component of the rate for collection of trash, recycling, and composting is based on total service volume, with a consistent charge across all volume irrespective of the type of service. The discount, taken as a reduction of the volumetric charge, is currently capped at 75 percent. The base rate covers certain system fixed costs outside of direct costs for trash, recycling, and composting service.

The Companies intend to implement some minor changes to the commercial rate structure. The changes are designed to maintain a sustainable revenue stream within the context of the movement towards zero waste, along with creating new incentives to drive further diversion by commercial customers. Commercial revenues are expected to increase as a result of the structural changes. The overall increase will be consistent with the approved residential and apartment increases. The increased commercial revenue is included in the rate model as a reduction of the revenue requirement used to calculate residential and apartment rates.

The fixed component of the rate is moving from 5 percent to 10 percent of each commercial bill. This change moves the fixed cost component closer to the actual fixed cost as a percentage of total cost. The variable component is correspondingly changed from 95 percent to 90 percent of each commercial bill.

Discounts of up to 75 percent of the variable component of each commercial bill is still available based on the proportion of recycling and composting service in excess of 10 percent, up to 85 percent of total volume. The first 10 percent is no longer eligible for a discount since there is now a minimum level of recycling and composting service required by the Mandatory Ordinance. For example, if a commercial customer has one 96-gallon bin for trash, one for recycling, and one for composting service, all collected once a week, then total diversion service volume represents 67 percent. The discount for this customer would be 57 percent (67% – 10%). If a customer has one 2-cubic-yard bin for trash, one 1-cubic-yard bin for recycling, and one 1-cubic-yard for composting, all collected once a week, then total diversion service volume is 50 percent and the discount would be 40 percent (50% – 10%).

5. Zero Waste Incentives

As the City and Recology pursue San Francisco's goal of zero waste, the recycling incentives must evolve to reflect the focus on further processing of materials and alternatives to landfill. For RY2014 and forward, the Companies propose zero waste incentives (ZWI) based solely on landfill disposal tonnage. As with the current diversion incentives, there would be four

operating ratio reward tiers of 0.5% each. For RY2014, the first tier would be equal to projected total disposal tons in Recology San Francisco Schedule E, adjusting to add back the new, and as yet unproven, black stream processing. The fourth tier would be the straight line amount from these tons to a 90% reduction in them by 2020. This recognizes that the final 10% of landfill reduction requires producer responsibility and new and yet to be proven technologies. The other two tiers would be equidistant between the first and fourth tiers. First tier targets in subsequent years will be based on expected changes in baseline tonnage.

The collection and distribution of ZWI funds when goals are met would remain the same as for the current diversion incentives. Since disposal reductions and consequently ZWI goals will be more challenging in future years, the Companies propose that when ZWIs are not achieved, the Companies be allowed to propose to utilize those funds for new diversion programs, subject to Department of the Environment and DPW approval.

6. Toxics Collection Incentives

The Companies and the City are currently advancing Extended Producer Responsibility (EPR) policies which require manufacturers of products needing special handling, such as paint, household batteries, and fluorescent lamps, to provide for end-of-life management of these products. To this end, the City is establishing an EPR Fund to receive end-of-life management payments from manufacturers. Under the Toxics Collection Incentives system, the Companies will become eligible for monies collected in the EPR Fund upon meeting performance targets established by the Department of the Environment. The goal of these incentives is to increase collection rates of certain specified materials such as paint, household batteries, and fluorescent lamps.

Table 1 below outlines the targets in terms of tons of each material the Companies will need to collect and the corresponding incentive. The incentives have two tiers and the incentive amount would be received for each tier that is achieved. In order to achieve a tier, the Companies must meet or exceed the tonnage targets for all three material categories. The total amount of the annual incentive will be capped at the dollar amount available in the EPR Fund, plus interest, on the last day of each rate year. If the second tier is not achieved, the Companies would be allowed to propose a program to utilize those funds subject to Department of the Environment and DPW approval.

Table 1 **RY**		**Batteries (tons)**	**Lamps (tons)**	**Paint (tons)**	**Incentive ($)**
14	Tier 1	86	46	407	82,188
	Tier 2	91	49	442	82,188
15	Tier 1	97	52	489	82,188
	Tier 2	103	55	535	82,188
16	Tier 1	109	59	600	82,188
	Tier 2	116	62	665	82,188

7. COLA

In the 2001 Rate Application, the Companies and the Rate Board approved a Cost of Living Adjustment (COLA) to enable the Companies to recover cost increases resulting from inflation over the five-year rate period (2001-2006). This COLA carried over to the 2006-2011 rate period, with modification to include a fuel index. The COLA that applied to the 2006 – 2011 rates had four adjustment components: (1) a labor component based on COLA increases included in the current labor agreements, (2) a Consumer Price Index (CPI) component for certain specified cost items, (3) a California Diesel Fuel Index and (4) a Producer Price Index (PPI) component for other certain specified cost items. A fifth component is for capital lease costs that are not subject to changes once the lease amounts are set.

The Companies propose to apply the COLA annually to the rate periods subsequent to the 2014 rate year until a new rate is set by the City as the result of a new rate proceeding. The COLA is updated to reflect the cost structure in the rate application with weightings of the COLA components adjusted as appropriate. The proposed COLA includes a labor component that is reflective of the current labor agreements, which include annual wage adjustments of between 3 percent and 5 percent. In addition, the Companies propose to modify the COLA by adding a component for health and welfare costs. As is widely recognized, health and welfare costs have increased greatly over the last several years and are expected to continue to rise. In addition, because of the uncertainty related to recent legislative and regulatory changes, the increase in costs could be quite dramatic and are hard to predict. The Companies propose to use a five-year average of historical cost increases, as determined by the Company's actuaries, as the proxy for future cost increases.

The proposed modified COLA is designed to ensure that the Companies fairly recover costs that increase during the periods subsequent to the 2014 rate period until a new rate is established through a new rate proceeding. This annual adjustment will protect both ratepayers and the Companies by increasing or decreasing rates in conjunction with economic trends and will eliminate the need for the Companies to submit an application for changes to the rates in the absence of significant new programs and/or facilities cost.

8. Special Reserve Surcharge

Under the Facilitation Agreement to the Altamont landfill disposal contract, a 1.3 percent surcharge was previously added to bills to provide a fund for unexpected cost increases associated with the contract (i.e., in between rate-setting processes) and to build a reserve for any future liabilities associated with disposal at the Altamont landfill. In the 2010 and 2012 rate processes conducted by the City, a determination was made that (1) the Special Reserve Fund had reached adequate levels to meet its intended uses and (2) the 1.3 percent surcharge should be redirected to the Department of Public Works for its costs associated with solid waste management. In the proposed rates, the City has directed the Companies to include the equivalent of the 1.3 percent surcharge in its rates and to eliminate the surcharge on top of the rates.

9. Landfill Contract

Under the current Rules of Procedure the Companies are required to submit a Notice of Intent to File [a Rate] Application several months before a new rate can take effect. DPW's rules allow shorter notice for applications submitted by the City. The City's landfill capacity under the current Altamont contract may be exhausted before the Companies submit their next rate application. In anticipation of that occurrence, the City may enter into new contracts for waste disposal and landfill transportation. Those new contracts could require the Companies to incur costs greater than those in the current application and consequent rate orders. The Companies therefore ask that a streamlined rate setting procedure be adopted that would allow the Rate Board and the Director of Public Works to order an interim rate adjustment if new contracts trigger additional costs prior to the next full rate proceeding.

10. Discount for E-Bill Customers

To encourage source reduction, E-bill customers will be credited $1 for each bill presented and paid electronically. Costs associated with providing this discount to existing customers is included in the rate application. Costs for discounts provided to additional customers that sign up for paperless billing will be borne by the Companies, as the cost will be partially offset by cost savings associated with reductions in printing and postage costs and the Companies recognize that it is an important sustainability issue.

IV. PROPOSED RATE STRUCTURE

A. RATE-SETTING BASIS

The rate application is based upon the combined revenues and expenses of the Companies. Revenue requirements and a consequent tipping fee are calculated at Recology San Francisco, with the consequent disposal and processing costs passed through to the Collection Companies. The costs of the Collection Companies are then used to calculate the individual rates charges for collection services.

Revenues and expenses are provided in 2014 dollars.

B. REVENUE REQUIREMENTS

The Revenue Requirement for the Collection Companies represents an increase of 21.51 percent over current revenues received by the Collection Companies. However, the Revenue Requirement only represents an increase of about 9 percent over Rate Year 2011 revenues approved in the 2006 rate-setting process. The major components of the need for additional revenue are (1) the migration of service from trash (black stream) to recycling service (blue stream) and composting service (green stream), (2) recovery of inflationary cost increases, and (3) new programs to support zero waste initiatives and support clean city programs.

C. PROPOSED RATES

As described in Section III, the Companies are proposing that residential rates include (1) a fixed charge, (2) a volumetric trash charge, (3) a volumetric recycling charge, and (4) a volumetric composting charge. The proposed monthly residential rates for weekly weekday collection are:

Fixed Charge = $5 per household dwelling unit

Volumetric Trash Charge = $25.51 per 32-gallons of bin capacity

Volumetric Recycling Charge = $2 per 32-gallons of bin capacity

Volumetric Composting Charge = $2 per 32-gallons of bin capacity

The proposed monthly apartment rates for weekly weekday collection are:

Fixed Charge = $5 per household dwelling unit

Volumetric Charge = $25.51 per 32-gallons of bin capacity

Discount of up to 75% of volumetric charge based on diversion capacity percentage minus 10 percent

All volumetric charges for residential and apartment customers, respectively, are proportional to the 32-gallon rates.

D. BREAKDOWN OF COST COMPONENTS

Following is an approximate breakdown of operating costs for the Companies:

- Labor represents the largest Company cost. Labor and benefits amount to nearly 64 percent of total costs.

- The next largest category is truck-operating costs, which represent approximately 14 percent of total costs. Truck-operating costs include fuel, oil, repair and maintenance, licenses, and City permits.

- Disposal and recycling processing costs (exclusive of labor and benefits costs) account for about 6 percent of total costs.

- Facility operating and maintenance costs represent about 9 percent of costs. Facility costs cover Recycle Central and Tunnel and Beatty, including the iMRF, transfer station, Public Reuse and Recycling Area PRRA, Household Hazardous Waste Collection Facility, scale facilities, administrative offices, and maintenance and related operational facilities.

- The remaining 7 percent of total costs consist of supplies, professional services, contract services, information technology, environmental and safety compliance, human resources, and accounting.

E. BREAKDOWN OF REVENUE INCREASE

The costs described above result in a revenue increase requirement of 21.51 percent. The contribution of major items is as follows:

1. The collection revenue shortfall due to migration to diversion services and the economic slowdown increases the required revenues by 16.1 percent.

2. The recycling revenue shortfall due to lower quantities and lower prices increases the required revenues by 2.1 percent.

3. Migration of existing customers to greater recycling and composting services and service reductions initiated in response to changes in rate structure increases required revenues by 1.6 percent.

4. Additional funding of City Departments and assumption of the abandoned material collection program increases required revenues by 1.8 percent.

5. Zero waste and other initiatives (Brisbane recycling fee, black stream processing, Less-Than-Weekly testing) increase the required revenues by approximately 2.0

6. Decreases in other expenses decreases required revenues by 2.3percent.
7. Benefit cost savings decrease the required revenues by 1.1 percent.

V. CONCLUSION

The Companies and the City share a common goal of attaining Zero Waste by 2020. In striving to achieve that goal, the Companies are working to (1) implement a zero waste rate structure that is sustainable as trash bins are minimized and ultimately eliminated and (2) begin the challenging task of trash processing. The Companies believe that the revisions to the rate structure proposed for Rate Year 2014 will create the foundation for a sustainable revenue stream to support the programs as the City and the Companies continue to move towards their joint objectives of zero waste. The rate request for revenue adjustments reflect program and cost changes and satisfy the requirement of the governing ordinance that rates be "just and reasonable."